IN THE

UNITED STATES COURT OF APPEALS FOR

THE NINTH CIRCUIT

ALETA G. COSTEN, et al., Appellants, vs. PAULINE'S SPORTSWEAR, INC., et al., Appellees.	No. 21387

APPELLANT'S OPENING BRIEF

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JURISDICTIONAL STATEMENT

Notice of appeal was filed with the District Court on April 27, 1966 [R. 154].* Appeal is taken from the Order of the District Court made and filed on April 5, 1966 [R. 153], and entered in the docket on April 6, 1966 [R. 163].

The United States Court of Appeals for the Ninth Circuit is vested with jurisdiction of this appeal from a final Order of the United States District Court for the Southern District of California, Northern Division, by Judicial Code §§ 1291 & 1294(1), 28 U.S.C. §§ 1291 & 1294(1).

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* Citations to the Record on Appeal throughout Appellant's briefs are in the above form, which indicates the page in the (Clerk's) Transcript of Record. There is no reporter's transcript.

SPECIFICATIONS OF ERROR

(1) The District Court erred by its order of April 5, 1966, dismissing the First Amended Complaint.

(2) The District Court erred by its order of January 14, 1966, dismissing the Complaint.

(3) The District Court erred by its order of November 24, 1965, granting defendants' motion to dismiss.

(4) The District Court erred by its order of November 24, 1965, in that its said order dismissed those claims stated under Sherman Act § 2, as amended, 15 U.S.C. § 2; Clayton Act §§ 3 and 4, 15 U.S.C. §§ 14 and 15 [Counts Two, Three, Five, Six, Eight, Nine, Eleven, and Twelve of the Complaint].

STATEMENT OF THE CASE

This appeal is taken by six persons, all plaintiffs below, from the District Court's order [R. 153] dismissing the first amended complaint. Appellees are Pauline's Sportswear, Inc., Robert C. Abild, and Desda S. Abild. One named defendant, Regal Accessories of New York, is not a party to this appeal. Appellants seek review of both the dismissal of the first amended complaint [R. 114, ff.] and the original complaint [R. 2, ff.]. The order dismissing the original complaint [R. 93-4], was clarified by the memorandum [R. 106] that stated findings were not required. Finally, a so-called "Judgment" [R. 111] was entered dismissing the complaint.

The first amended complaint [R. 114, ff.] was filed on February 10, 1966. On April 5, 1966 the District Court made its order [R. 153] dismissing the first amended complaint "for the reasons set forth in the dismissal of the original complaint." At this point, Appellants filed their notice of appeal and thereby abandoned any further opportunity to amend

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hereby abandoned any further opportunity to amend their pleading.

Of course there is no Reporter's Transcript filed in this cause, as the only factual matter before this court consists solely of allegations in the original and the amended complaint. Plaintiffs charged violations of Sherman Act §§ 1 and 2, and Clayton Act § 3, and sought treble damages under Clayton Act § 4, as amended.

The original complaint was in twelve counts, in groups of three counts. Each group of three counts was based upon relations of the defendants with one particular franchise operation, there being four franchise operations involved in this action. There is no substantial difference in the allegations relative to one operation or another. Counts One, Four, Seven, and Ten charge resale price maintenance in violation of Sherman Act § 1. Counts Two, Five, Eight, and Eleven charge a monopolization violation of Sherman Act § 2. Counts Three, Six, Nine, and Twelve charge violation of Sherman Act § 1 [cited as "§ 2"] and Clayton Act § 3, through exclusive dealing and illegal

tie-ins.

The first amended complaint simply omitted the charged violations of Sherman Act § 1 as to each of the four franchise operations. Thus, the amended complaint did not rely on any claims of resale price maintenance, but included the charges of monopolization, exclusive dealing, and illegal tie-ins. The following factual statement is taken from the original complaint, Counts One, Two, and Three, on behalf of Appellant, Aleta G. Costen.

On June 20, 1964 Appellees made a franchise agreement with Mrs. Costen for a retail ladies' sportswear shop at the Bay Fair Shopping Center in San Leandro, California. The franchise agreement required her to purchase all merchandise requirements from Appellees, and the Appellees prohibited her merchandising at that location any ladies' sportswear produced or sold by anyone other than the Appellees. The premises were sub-leased to Mrs. Costen by Appellees.

As alleged in paragraph three of Count Three

[R. 7] of the original complaint:

> "Said sub-lease and said franchise agreement were expressly conditioned upon restrictions that plaintiff COSTEN deal only in ladies' sportswear manufactured and supplied by defendants and plaintiff COSTEN was expressly prohibited from purchasing or selling merchandise manufactured or sold by anyone other than the defendants; such restrictions tied the tenancy under said sub-lease to an obligation to purchase women's sportswear for resale from the defendants."

It was further alleged, in paragraph seven [R. 8], that:

> "That as a consequence of the aforesaid restrictions set forth in Paragraph Three of this cause of action, plaintiff COSTEN, because she feared that the defendants would forfeit her franchise and evict her otherwise, did not deal in the goods or merchandise of other manufacturers and distributors of ladies' sportswear than the defendants, and as a consequence thereof was unable to profitably operate a business of retail sales of clothing at the aforesaid location in the City of San Leandro, and plaintiff COSTEN was therefore damaged, as above alleged."

The complaint further alleges that (1) a purpose and effect of the combination was to unreasonably and arbitrarily monopolize or attempt to monopolize commerce in ladies' sportswear, (2) seventy-five such franchise and sub-lease agreements were made

throughout California with the purpose and effect of controlling merchandising of ladies' sportswear, (3) the franchisees were prohibited from engaging in similar business in California, from merchandising other ladies' sportswear, and from merchandising similar goods produced by others, and (4) that Appellees "possessed monopoly power over the merchandise sold to plaintiff COSTEN, in that it bore the defendant's trade name 'Pauline's Sportswear.' "

ARGUMENT

I. DISMISSAL OF THE CLAIMS AT THE PLEADING STAGE WAS IMPROPER AS A MATTER OF PROCEDURE.

The Appellees' motions to dismiss the action for the asserted insufficiency of the complaint raises two significant questions: (1) whether franchising arrangements should generally be considered exempt from the antitrust laws, and (2) whether complaints based upon alleged illegal franchising arrangements can be disposed of at the pleading stage of the proceedings.

The motions were seemingly based upon Fed. R. Civ. P., Rule 12(b). Appellants have found a similar case, which was also presented on a motion to dismiss for failure to state a claim. This decision is _Hathaway Motors_ v. _General Motors Corporation_, 18 F. R. D. 283 (D. Conn. 1955). This case was filed for treble damages under the antitrust laws against a group of franchisors, including General Motors Corporation. The District Court observed that the damages alleged were that plaintiffs had been forced out of

business because they were not able to compete with the franchise dealers. This fact of the Hathaway case is the only difference from the one now at bench. The pleading issue is identical, and as in the Hathaway case, the motion to dismiss should not have been granted.

The Court in Hathaway Motors held that circumstantial evidence could conceivably uphold the general allegations of the complaint, and therefore denied the motion to dismiss. The Court observed:

> "In dealing with a motion to dismiss for failure to state a claim, the rule of Dioguardi v. Durning, 10 Cir. 1944, 139 F.2d 774, should be kept in mind. Such dismissal should not be granted unless it appears to a certainty that plaintiff is entitled to no relief under any state of facts which could be proved in support of the claim." 18 F.R.D. at 284.

The Hathaway decision was roundly approved by the late Judge Charles E. Clark, who in large measure drafted the Civil Rules. See Clark, "Special Pleading in the 'Big Case'," 21 F.R.D. 45, 52 (1957); and it was approved by the Court of Appeals in Nagler v.

Admiral Corporation, 248 F.2d 319, 325-6 (2d. Cir. 1957).

Another such similar case is P. H. Machinery v. Harnischfeger Corporation, 207 F.Supp. 392 (D Minn. 1962). In This case also the motion before the court was one to dismiss the complaint, and defendants additionally had moved for summary judgment. Plaintiff alleged that it had entered into dealer agreements with defendant for sale and service of certain equipment manufactured by defendant. In overruling the motions to dismiss and for summary judgment on the claim asserted under the Sherman Act and Clayton Act, the Court held as follows:

> "It is undoubtedly true, as the cases cited by defendant indicate, that under certain circumstances an exclusive dealership agreement between a manufacturer and a dealer, similar to the one herein alleged, may not in and of itself constitute a violation of the anti-trust laws. However, the complaint not only alleges an exclusive dealership agreement between defendant and Mesaba, but goes on to allege that the purpose and result of such agreement has been to conspire to eliminate competition and restrain trade and to acquire a monopoly. A showing of such

> circumstances surrounding an agreement of this type might well make out a case for violation of the Sherman Anti-Trust Act, and, consequently, it does not appear to a certainty that plaintiff would be entitled to no relief under any state of facts which could be proved in support of the claim." 207 F.Supp. 394-5.

One of Appellees' principal contentions has been that a dealer-franchisee has no standing to prosecute a treble damage action arising out of his relationship with his supplier-franchisor. This notion is neatly rebutted by the decision in Girardi v. Gates Rubber Co., 325 F.2d 196 (9th Cir. 1963). The Ninth Circuit there held that plaintiff was entitled to try his antitrust action, even though plaintiff Girardi had followed the suggested pricing from March, 1951, until early 1954. 325 F.2d at 197.

The exclusive dealing arrangements, alleged herein, are illegal, depending upon proof of relative strength of the parties, the proportionate volume of commerce involved, and the effects on competition in the market. Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320, 324 (1961). These questions simply can

> circumstances surrounding an agreement of this type might well make out a case for violation of the Sherman Anti-Trust Act, and, consequently, it does not appear to a certainty that plaintiff would be entitled to no relief under any state of facts which could be proved in support of the claim." 207 F.Supp. 394-5.

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II. APPELLEES' FRANCHISES WERE ILLEGALLY TIED TO THE FRANCHISORS' POSSESSORY RIGHTS TO THE PARTICULAR LOCATIONS, BY USE OF SUB-LEASES.

One of the Appellees' contentions before the lower court was that as a single trader and franchisor it was somehow exempted from application of the antitrust laws. It is not apparent whether or not the District Court adopted this point of view. The contention is mistaken, however, as best stated in an opinion of Chief Judge Sobeloff, Osborn v. Sinclair Refining Company, 324 F.2d 566, 573 (4th Cir. 1963).

In the Osborn case the defendant required its gasoline dealers, as a condition for leasing service stations and purchasing gasoline from it, also to buy substantial quantities of tires, batteries, and accessories. Sinclair's principal defense was that its conduct in terminating the plaintiff was a simple unilateral refusal to deal, lawful under United States v. Colgate & Co., 250 U.S. 300 (1919). Chief Judge Sobeloff relied upon the decision in United States v. Parke, Davis & Co., 362 U.S. 29 (1960), in

dealing with this argument, stating:

> "There the Court indicated that if a seller does no more than announce a policy designed to restrain trade, and declines to sell to those who fail to adhere to the policy, he has not put together a combination or arrangement violative of the antitrust laws. However, the Court emphasized that if the seller goes further, if he engages in actions extending beyond the bare announcement of his policy and the declination to sell "and he employs other means which effect adherence" to his policy, he has engaged in a combination or arrangement condemned by the antitrust laws. He can then no longer rely upon his "right" of customer rejection. There is no indication in Parke, Davis, or in any other case, that these principles regarding refusals to deal vary, depending upon whether there is a monopoly or concerted action with co-conspirators, or whether, on the other hand, there exists some other form of arrangement in restraint of trade. To the contrary, irrespective of monopoly or conspiracy, if the seller pressures his customers or dealers into adhering to resale price maintenance, or exclusive dealing or tie-ins, he has put together an unlawful arrangement and taken himself outside the narrow protection afforded by Colgate." 324 F.2d 573.

"Tying arrangements have been defined as agreements by a party to sell one product only on the condition that a buyer also purchase a different, or tied

product, from the seller, or that a buyer not purchase the tied product from any other supplier." Comment, 74 Yale L. J. 691 (1965). One of the most recent decisions involving tying arrangements is United States v. Loew's Incorporated, 371 U.S. 38 (1962), which was a challenge against block booking of motion pictures on television as violative of Sherman Act § 1. The Court there observed that "tying arrangements once found to exist in context of sufficient economic power, are illegal 'without elaborate inquiry as to . . . the business excuse for their use,' Northern Pacific R. Co. v. United States, 356 U.S. 1, 5." 371 U.S. 51-52.

Appellants, at this stage in the case at bench, do not contend that the sub-lease tie-in is or is not subject to application of a per se test such as that of International Salt Co. v. United States, 332 U.S. 392 (1947).

Rather, Appellants contend that the controlling test is that laid down in Northern Pacific Ry. v. United States, 356 U.S. 1 (1958), holding that tying arrangements,

> "are unreasonable in and of themselves whenever a party has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product and a 'not insubstantial' amount of interstate commerce is affected." 356 U.S. at 6.

Appellants are not taking the same position as was taken by the plaintiffs in <u>Susser</u> v. <u>Carvel Corp</u>., 332 F.2d 505 (2d Cir. 1964), wherein plaintiffs stipulated that they were relying solely on <u>per</u> <u>se</u> violations of the antitrust law. There is another distinction from the <u>Carvel</u> case, namely, that the present appeal involves a true tie-in because the subleases bind the physical premises to the exclusive-dealing franchise agreement.

This aspect of the present case also brings it within the provisions of Clayton Act § 3, 15 U.S.C. § 14. Appellants recognize that proof of Clayton Act § 3 violation must include a showing that the arrangement substantially lessened the competition or tended to create a monopoly in a line of commerce. The District Court, however, did not allow Appellants to go to trial on this issue or any other issue.

A recent decision of this court, Lessig v. Tidewater Oil Co., 327 F.2d 459 (9th Cir. 1964), a treble damage suit by a service station operator, explains the bases of the Sherman Act § 1 tie-in claim. In Lessig the court held that a tying arrangement was unlawful under Section 1:

> (1) when there is sufficient economic power to impose an appreciable restraint on free competition in the tied product;
>
> (2) that this power may be inferred from the tying product's desireability or uniqueness;
>
> (3) power to monopolize need not be demonstrated;
>
> (4) full scale inquiry into the scope of the relevant market and the seller's share is unnecessary; and
>
> (5) the requisite control of the tying product may be inferred from the seller's success in imposing a tying condition upon a substantial amount of commerce in the tied product.
>
> 327 F.2d at 469-470.

Certainly the allegations in both the original and the amended complaints in the present case embrace facts sufficient to support a finding of an

illegal tie-in under these requirements of the Lessig case. The tied product is ladies' sportswear and the tying product is the leased space or franchise location.

III. APPELLANTS SHOULD HAVE THEIR DAY IN COURT TO PROVE THEIR CLAIM UNDER CLAYTON ACT § 3.

The preceding argument attacking the tie-in aspects of the franchises touches upon Appellants' claims under Clayton Act § 3. Section 3, however, strikes particularly at exclusive dealing practices. It has been said that the test of Section 3 "is a somewhat friendlier test than that applied to tie-ins, since it requires proof of a substantial share of a relevant market . . . . " Kaysen & Turner, Antitrust Policy 147 (1959).

The leading case on exclusive dealing, applying Clayton Act § 3, is Standard Oil Co. of Calif. v. United States, 337 U.S. 293 (1949), holding that exclusive supply contracts with independent dealers were illegal. The Court there interpreted the qualifying language of Section 3, namely, "where the effect . . . may be to substantially lessen competition or tend to create a monopoly in any line of commerce." After examining and rejecting many suggested tests, the Court held, "the qualifying clause of § 3 is satisfied by

proof that competition has been foreclosed in a substantial share of the line of commerce affected." 337 U.S. at 314.

The original complaint in Count Three, paragraph 6 [R. 8], set up the factual claim in accord with the <u>Standard</u> <u>Oil</u> <u>Co</u>. criterion with these allegations:

> "The purpose and effect of the aforesaid restrictions and sales were to substantially lessen competition or tended to create a monopoly in ladies' sportswear by unreasonably and arbitrarily restricting the opportunity of defendants' competitors to market their products."

The same allegations appear again in Count Two, paragraph 6 of the first amended complaint [R. 119].

The effect in the instant case is, of course, the same effect as obtained in <u>Standard</u> <u>Oil</u> <u>Co</u>., <u>supra</u>. When the franchisee or dealer observes his contract, he forecloses his franchisor's competitors from "whatever opportunity there might be to attract his patronage." 337 U.S. at 314. Or, as the Court also said, "use of the contracts creates just such a clog on

competition as it was the purpose of § 3 to remove . . . . " _Ibid_.

A strikingly similar case, decided after _Standard Oil Co._, _supra_, is _United States_ v. _Richfield Oil Corp._, 99 F.Supp. 280 (S.D. Cal. 1951), aff'd per curiam, 343 U.S. 665 (1952). The _Richfield_ decision involved "leased-out" stations as well as dealer stations. The leased-out station arrangements were similar to the Pauline's Sportswear sub-lease franchises, in that the lease included a clause "merging into the instrument all other agreements." 99 F.Supp. at 287. The trial judge found, as a matter of fact, that the leases,

> "and the oral agreements superimposed on them confine the operations of the stations to which they apply to dealing exclusively with Richfield petroleum products and automotive accessories handled or sponsored by Richfield." 99 F.Supp. at 297.

The judgment that the agreements were illegal and enjoinable was affirmed per curiam on the authority of the _Standard Oil Co._ case, _supra_. 343 U.S. 665 (1952).

Finally, it is submitted that allegations of the instant complaint were well within the standards prescribed by this court in <u>Lessig</u> v. <u>Tidewater Oil Co</u>., 327 F.2d 459 (9th Cir. 1964), for a jury verdict based upon Clayton Act § 3. See 327 F.2d at 467-470. It is respectfully submitted that Appellants should be accorded the same opportunity as are other litigants to prove their claims under Clayton Act § 3.

IV. APPELLANTS SHOULD HAVE THEIR DAY IN COURT TO PROVE THEIR CLAIM UNDER SHERMAN ACT § 2.

Count Two of the original complaint [R. 5-7] set up Mrs. Costen's claim under Sherman Act § 2, alleging, in part:

> "An additional purpose and an additional effect of the aforesaid combination or conspiracy was to unreasonably and arbitrarily monopolize or attempt to monopolize that part of the trade or commerce among the several states having to do with the sale and distribution of manufactured ladies' sportswear." [R. 5-6].

As was true of all but the Sherman Act § 1 allegations, the District Court in no way mentioned or discussed any reason for dismissing the complaint as to Counts Two, Five, Eight, and Eleven - the Sherman Act § 2 counts. See Order Granting Defendants' Motion to Dismiss filed on November 24, 1965 [R. 93-94]. Nor did the order [R. 153] disposing of the amended complaint state any reasons for the District Court's action.

We turn, then, to a somewhat similar case wherein the trial judge withdrew Section 2 charges from the jury, _Lessig_ v. _Tidewater Oil Co._, 327 F.2d 459 (9th Cir. 1964), discussed _supra_. _Lessig_ was a matter

where Tidewater's exclusive dealing and tie-in arrangements were attacked. In its decision reversing the trial judge, this court held as to Section 2, that:

> "The essence of monopoly is power to control prices and exclude competition, and what we have said demonstrates that there was evidence that Tidewater possessed the specific intent to acquire and exercise such power with respect to a part of commerce.
>
> * * * *
>
> "We reject the premise that probability of actual monopolization is an essential element of proof of attempt to monopolize. Of course, such a probability may be relevant circumstantial evidence of intent, but the specific intent itself is the only evidence of dangerous probability the statute requires - perhaps on the not unreasonable assumption that the actor is better able than others to judge the practical possibility of achieving his illegal objective.
>
> "When the charge is attempt (or conspiracy) to monopolize, rather than monopolization, the relevant market is 'not in issue.' United States v. E. I. Du Pont & Co., 351 U.S. 377, 395 n. 23 (1956)."
>
> 327 F.2d at 474.

See also Judge Learned Hand's opinion in the famed *Alcoa* case, *U. S.* v. *Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945). Although the *Alcoa* facts are unique, one principle of that decision is important to the present case, namely, that the intent violative of Section 2 may be implicit in the monopolistic conduct.

Further, Section 2 reaches plans or programs to monopolize, even though there be no monopolistic result at the time the suit is filed or tried. *Times-Picayune Pub. Co.* v. *U. S.*, 345 U.S. 594 (1953). Appellants submit they have a right to test their Section 2 allegation, whether it be to prove a monopolistic conspiracy or an attempt to create a monopoly.

CONCLUSION

Appellants began their argument from the premise that this action should not be determined at the pleading stage, although it would necessarily be a difficult, tedious case to try. In ensuing sections of this brief, Appellants have sought to demonstrate that their allegations do set forth claims upon which relief may be granted.

It is noted that only the allegations of the Costen counts have been examined in detail, but the claims of the other Appellants are nearly identical in substance. Appellants respectfully submit that all claims of the original complaint are entitled to a full hearing as to the legality of the purpose, design, and effect of Appellees' franchising practices. It is submitted that the District Court should be reversed and the cause remanded with directions that Appellees answer the original complaint.

Respectfully submitted,

FULLERTON, LANG & RICHERT

By_________________________
William T. Richert

ATTORNEY'S CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

William T. Richert